

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:MAN:TL-N-1011-99
JDPappas

date:

to: Chief Examination, Manhattan District
Attn. Gerald Feig
QMS:A:9th Floor

from: District Counsel, Manhattan

subject: [REDACTED]
I.R.C. §6402(b) credit elect issue

UIL Number: 6402.01-02

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On August 17, 1999, we provided you with advice concerning when deficiency interest runs in the context of an election to have a refund applied to the subsequent year's estimated tax payment. In further discussions, you pointed out that the taxpayer did not need or wish to use the overpayment credit elect for the third and fourth estimated quarterly tax payments. As a result, our conclusions have changed, which we provide below.

ISSUE:

1. Whether underpayment interest began to accrue on [REDACTED]'s (" [REDACTED] ") deficiency in tax for [REDACTED] prior to [REDACTED].

FACTS:

On or about [REDACTED], [REDACTED] filed its Form 1120 (U.S. Corporation Income Tax Return) for [REDACTED] (extended from [REDACTED] due date). On its Form 1120 for [REDACTED] [REDACTED] reported an overpayment of \$[REDACTED], which [REDACTED] elected to have credited against its liability for estimated tax for [REDACTED]. However, [REDACTED] did not designate against which installment of estimated tax the overpayment for [REDACTED] was to be applied. Thus, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254, the Service should have credited the overpayment against [REDACTED]'s estimated tax for [REDACTED] as of [REDACTED], the due date for [REDACTED]'s first installment of estimated tax for [REDACTED]. See also, *Avon Products v. United States*, 588 F.2d 342 (2nd Cir. 1978). [REDACTED] now estimates its tax payments for tax year [REDACTED] as follows:

Installment	Due Date	Amount Due	Amount Deposited
1 st	[REDACTED]	\$[REDACTED]	\$[REDACTED]
2 nd	[REDACTED]	\$[REDACTED]	\$[REDACTED]
3 rd	[REDACTED]	\$[REDACTED]	\$[REDACTED]
4 th	[REDACTED]	\$[REDACTED]	\$[REDACTED]

As a result of the audit of [REDACTED]'s tax year [REDACTED], the Service determined that there was a deficiency of \$[REDACTED] for that year. [REDACTED] paid the additional assessment of tax and interest, and on [REDACTED], it filed a claim for refund with respect to a portion of the assessed interest. In response to [REDACTED]'s informal claim, the Service recomputed the deficiency interest, accruing it from [REDACTED], the date of the subsequent year's first quarterly estimated tax installment. [REDACTED] contends that the overpayment was never needed in its entirety. [REDACTED] further contends that interest should accrue on a portion of the deficiency as the credit elect overpayment is used: [REDACTED], used \$[REDACTED] of credit elect and [REDACTED], \$[REDACTED].

LAW AND ANALYSIS:

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due and unpaid. I.R.C. § 6601(a); *Avon Products v. United States*, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the

¹ The Service erroneously posted the overpayment as a "credit transfer" instead of a "credit elect."

taxpayer elected to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to or less than the amount of the return overpayment as of the effective date of the credit elect; interest will begin to accrue on the amount of the deficiency in excess of the return overpayment as of the original due date of the return. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.² Pub. L. No. 98-369, 98 Stat. 494. Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election.

1977-2 C.B. at 476 (emphasis added). Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356. However, the deficiency only becomes both due and unpaid, and thus triggers the running of interest on that deficiency, when the overpayment balance, after the application to the succeeding tax year's estimated taxes, is less than the deficiency for the overpayment year.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally was crediting a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that

² In 1983, the Service revoked Revenue Ruling 77-475. Rev. Rul. 83-111, 1983-2 C.B. 245. However, in response to tremendous public criticism and expected Congressional action, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475 on March 30, 1984.

designated otherwise. However, in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed to be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment and the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996). On August 4, 1997, the Service acquiesced in the *May Department Stores* decision. *May Department Stores Co. v. United States*, AOD CC-1997-008.³

In light of the *May Department Stores* decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under I.R.C. § 6655 with respect to such year.

³ The *May Department Stores* action on decision provides that,

for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return.

May Department Stores Co. v. United States, AOD CC-1997-008 (Aug. 4, 1997).

The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of I.R.C. § 6601(a). Prior to that date the government has had the use of the funds with respect to the prior year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. See I.R.C. § 6402(b); Treasury Reg. § 301.6402-3(a)(5) and § 301.6611-1(h)(2)(vii). Interest should be charged from the point the prior year's tax is both due and unpaid. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997); *Avon Products, Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356. Revenue Ruling 84-58 requires the taxpayer to attach a statement to its return, designating the installment of estimated tax against which the overpayment should be applied. However, we now think that a taxpayer may make a retroactive designation if it made the election to credit the return overpayment on the original return without designating a specific installment and the period of limitations for filing a refund claim has not expired.

█'s tax year █ does not fit within the fact pattern set forth in *May Department Stores* because █ had not fully paid its first installment of estimated tax for tax year █ without the application of a portion of the return overpayment for tax year █. In addition, █'s deficiency is \$█ for its █ tax year, greater than the \$█, overpayment for █. The deficiency amount that is in excess of the overpayment reflected on the █ return ($\$█ - \$█ = \$█$) should accrue deficiency interest from the original due date of the tax for █ (█). That portion is both due and unpaid as of the due date of the return. █ applied a portion of the █ overpayment to the first installment of █ estimated taxes due on █, in the amount of \$█. After the application to this installment, there was a balance of \$█ remaining of the █ overpayment. At the time of that application of the █ overpayment credit (█), the overpayment credit was less than the █ deficiency and interest begins to run on an additional \$█ of the deficiency. Thus, at this time (█) an additional

' The overpayment credit was less than the deficiency amount from the outset, but the government had use of the taxpayer's money equal to the credit elect amount until its first application. Thus, the portion of the deficiency equal to the credit elect does not become due and unpaid until the application of the

\$ [REDACTED] of the [REDACTED] deficiency became both due and unpaid and interest began to run on that amount (in addition to the [REDACTED]). [REDACTED] needed \$ [REDACTED] of the overpayment to pay the second installment for [REDACTED]. As a result of the application of that amount to pay the second installment of estimated taxes for [REDACTED], interest begins to accrue on an additional \$ [REDACTED] of the [REDACTED] deficiency from the due date of the second installment of estimated tax for [REDACTED] ([REDACTED]). H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356.

Where the overpayment is not needed to satisfy any installment of estimated tax in the succeeding year, the overpayment would be treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises. See also I.R.C. § 6513(a) which provides that a payment of income tax made before the date prescribed for payment of the tax is considered paid on that date. The date prescribed for payment of tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). I.R.C. § 6151. Further, it is on this date that the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under I.R.C. § 6611(a) and (d). Thus, we conclude that the statute requires that an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year must be treated as a payment against the next year's tax liability with an effective date no later than the due date of the next year's return. Thus, as of the due date of the next year's return ([REDACTED]), the Service no longer has use of the overpayment credit for [REDACTED]. It is at this point that deficiency interest will run on the entire deficiency.

credit elect amount (in this case [REDACTED]).

CONCLUSION:

Based on the foregoing, we recommend that you assess deficiency interest on the portion of the deficiency in excess of the credit elect overpayment amount (\$ [REDACTED]) as of [REDACTED] and on the entire deficiency (\$ [REDACTED]) as of [REDACTED] and on a prorated basis between [REDACTED] and [REDACTED] as discussed above. We will contact you within two weeks of this memorandum to discuss the National Office comments, if any, about this proposed advice. Should you have any questions regarding this matter, please contact Jeannette D. Pappas of our office at (212) 264-1595, Ext. 243.

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